

MISSOURI LOTTERY

FINANCIAL STATEMENTS AS OF
JUNE 30, 1997 AND 1996
TOGETHER WITH AUDITORS' REPORT

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Missouri Lottery Commission:

We have audited the accompanying balance sheets of the Missouri Lottery and the Missouri Lottery Grand Prize Winners Trust Account as of June 30, 1997 and 1996, and the related statements of revenues, expenditures and retained earnings, cash flows and changes in grand prize winners trust account for the years then ended. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Missouri Lottery and the Missouri Lottery Grand Prize Winners Trust Account as of June 30, 1997 and 1996, and the results of operations, cash flows and changes in grand prize winners trust account for the years then ended in conformity with generally accepted accounting principles.

Arthur Andersen LLP

St. Louis, Missouri,
October 10, 1997

MISSOURI LOTTERY

BALANCE SHEETS AS OF JUNE 30, 1997 AND 1996

	<u>1997</u>	<u>1996</u>
<u>ASSETS</u>		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 15,281,454	\$ 19,946,523
Accounts receivable	18,065,213	15,752,240
Ticket inventories	389,126	132,065
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Total current assets	33,735,793	35,830,828
PROPERTY AND EQUIPMENT	7,079,673	7,144,907
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Total assets	\$ 40,815,466	\$ 42,975,735
	=====	=====
<u>LIABILITIES AND RETAINED EARNINGS</u>		
CURRENT LIABILITIES:		
Accounts payable	\$ 6,493,473	\$ 5,356,852
Due to Lottery Proceeds Fund	2,251,743	3,856,322
Accrued prize liabilities	24,918,706	26,934,066
Other accrued liabilities	1,551,182	1,294,778
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Total current liabilities	35,215,104	37,442,018
OTHER DEFERRED LIABILITIES	5,600,362	5,533,717
RETAINED EARNINGS	-	-
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Total liabilities and retained earnings	\$ 40,815,466	\$ 42,975,735
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The accompanying notes are an integral part of these balance sheets.

MISSOURI LOTTERY

STATEMENTS OF REVENUES, EXPENDITURES AND RETAINED EARNINGS

FOR THE YEARS ENDED JUNE 30, 1997 AND 1996

	<u>1997</u>	<u>1996</u>
OPERATING REVENUES:		
On-line ticket sales	\$ 188,757,331	\$ 194,204,706
Instant ticket sales	222,342,990	198,735,269
Pull-tab ticket sales	28,491,979	29,590,970
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Total operating revenues	439,592,300	422,530,945
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OPERATING EXPENDITURES:		
On-line prize expense	95,393,749	98,676,688
Instant prize expense	128,488,183	112,089,536
Pull-tab prize expense	17,981,392	18,754,308
On-line retailer commissions and incentives	10,763,645	11,085,507
Instant retailer commissions and incentives	14,661,085	12,968,376
Pull-tab retailer commissions and incentives	2,325,782	2,397,278
Cost of tickets sold	10,805,208	12,556,996
Advertising and promotions	10,714,037	11,264,564
Wages and benefits	6,527,615	6,093,406
Other general and administrative	10,605,205	10,002,209
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Total operating expenditures	308,265,901	295,888,868
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Operating revenues over expenditures	131,326,399	126,642,077
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NONOPERATING REVENUES:		
Interest income	1,045,038	1,124,258
Other	292,490	291,825
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Total nonoperating revenues	1,337,528	1,416,083
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Income before transfers	132,663,927	128,058,160
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TRANSFERS TO STATE OF MISSOURI:		
Operating transfers	(132,663,927)	(128,058,160)
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Excess of revenues over expenditures and transfers	-	-
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RETAINED EARNINGS AT BEGINNING OF YEAR	-	-
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RETAINED EARNINGS AT END OF YEAR	\$ -	\$ -
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The accompanying notes are an integral part of these statements.

MISSOURI LOTTERY

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED JUNE 30, 1997 AND 1996

	<u>1997</u>	<u>1996</u>
CASH FLOWS PROVIDED BY OPERATING ACTIVITIES:		
Income before transfers	\$ 132,663,927	\$ 128,058,160
Adjustments to reconcile income before transfers to net cash provided by operating activities-		
Operating cash transfers	(134,201,860)	(132,311,303)
Depreciation	2,338,150	2,255,563
Gain on sale of assets	(160,647)	(152,893)
Grand prizes deferred	12,593,179	7,579,018
Transfers to Grand Prize Winners Trust Account	(12,593,179)	(7,579,018)
Change in assets and liabilities-		
(Increase) in accounts receivable	(2,312,973)	(1,822,617)
Decrease in other assets	-	337,639
(Increase) decrease in ticket inventories	(257,061)	268,394
Increase in accounts payable and other accrued liabilities	1,393,025	1,073,533
Increase (decrease) in accrued prize liabilities	(2,015,360)	4,637,104
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Net cash (used in) provided by operating activities	(2,552,799)	2,343,580
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CASH FLOWS FROM INVESTING ACTIVITIES:		
Additions to property and equipment	(2,279,919)	(1,819,640)
Proceeds from sale of assets	167,649	196,700
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Net cash used for investment activities	(2,112,270)	(1,622,940)
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CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments on capital lease obligations	-	(848,419)
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Net cash used for financing activities	-	(848,419)
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Net decrease in cash	(4,665,069)	(127,779)
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CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	19,946,523	20,074,302
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CASH AND CASH EQUIVALENTS AT END OF YEAR	\$ 15,281,454	\$ 19,946,523
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The accompanying notes are an integral part of these statements.

MISSOURI LOTTERY

GRAND PRIZE WINNERS TRUST ACCOUNT

BALANCE SHEETS AS OF JUNE 30, 1997 AND 1996

	<u>1997</u>	<u>1996</u>
<u>ASSETS</u>		
INVESTMENTS	\$ 96,944,238 =====	\$ 87,181,902 =====
<u>LIABILITIES</u>		
DEFERRED GRAND PRIZE LIABILITY	\$ 96,944,238 =====	\$ 87,181,902 =====

MISSOURI LOTTERY

STATEMENTS OF CHANGES IN GRAND PRIZE WINNERS TRUST ACCOUNT

FOR THE YEARS ENDED JUNE 30, 1997 AND 1996

	<u>1997</u>	<u>1996</u>
TRANSFERS FROM MISSOURI LOTTERY	\$ 12,593,179	\$ 7,579,018
INTEREST ACCRETION	6,541,157	6,136,117
PAYMENTS TO GRAND PRIZE WINNERS	(9,372,000)	(8,640,000)
Net increase	<u>9,762,336</u>	<u>5,075,135</u>
BALANCE AT BEGINNING OF YEAR	87,181,902	82,106,767
BALANCE AT END OF YEAR	<u>\$ 96,944,238</u> =====	<u>\$ 87,181,902</u> =====

The accompanying notes are an integral part of these statements.

MISSOURI LOTTERY

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 1997 AND 1996

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The Missouri Lottery (the Lottery) is accounted for as a proprietary type enterprise fund, is a component unit of the State of Missouri and is exempt from income taxes. The financial statements are prepared in accordance with generally accepted accounting principles on the accrual basis of accounting and conform with practices generally followed in the gaming industry.

Revenue Recognition

Sales of on-line lottery tickets are generated by the semiweekly "LOTTO" and "Powerball" games, and the daily "Show-Me 5," "Daily Millions" and "PICK 3" games. Sales of lottery tickets are made through licensed retail sales outlets via on-line terminals maintained by the retailers. Ticket sales are recognized at the time the player purchases a ticket from the retailer.

Sales of instant lottery tickets are made to licensed retail sales outlets with the right of return. Ticket sales are recognized upon the sale of tickets to licensed retailers and are valued at the sale price to the player. Allowances have been established for estimated tickets to be returned by retailers of approximately \$376,000 and \$288,000 at June 30, 1997 and 1996, respectively.

Sales of pull-tab lottery tickets are made to licensed retail sales outlets with no right of return. Ticket sales are recognized upon the sale of tickets to retailers and are valued at the sale price to the player.

Prizes

Expenditures for on-line lottery ticket prizes are recorded based on a minimum of 45% of on-line lottery ticket sales. The minimum grand prize amount for the semiweekly "LOTTO" game is \$1,000,000. Grand prize winners have the choice of receiving the prize in 20 annual installments or a portion of the prize in one lump-sum payment. Any prize that remains unclaimed for one year from the date of the on-line game drawing is used to fund future prize pools.

Expenditures for instant lottery ticket and pull-tab lottery ticket prizes are recorded based upon the unique, predetermined prize structure for each game and are accrued as tickets are sold to the retailer.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash and money market funds on deposit with the State Treasurer and banks. The cash on deposit with the State Treasurer is pooled with other Missouri state funds and is fully secured by the depository institutions holding the funds. The Lottery considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Retailer Fees

Licensed retailers are charged a fee for the right to sell lottery tickets. Additionally, certain retailers pay an annual fee in lieu of obtaining an insurance bond. Such fees are maintained in a reserve fund to offset uncollectible accounts receivable from retailers. This reserve fund approximated \$493,000 and \$561,000 at June 30, 1997 and 1996, respectively, and is reflected as a reduction of accounts receivable on the accompanying balance sheets.

Ticket Inventories

Ticket inventories consist of instant and pull-tab tickets purchased by the Lottery for new games which have not been implemented. Inventories are carried at cost, using the specific identification method. Tickets are charged to cost of tickets sold upon implementation of the game.

Property and Equipment

Property and equipment are carried at cost, less accumulated depreciation. Depreciation is computed on the straight-line method over the estimated life of the related asset. When assets are retired or otherwise disposed, the cost and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recognized in income for the period.

Due to Lottery Proceeds Fund

All income before operating transfers of the Lottery, as described in the accompanying statements of revenues, expenditures and retained earnings, accrues to the benefit of the State of Missouri. Operating transfers are made to the Lottery Proceeds Fund, which shall be appropriated by the State solely for the institutions of elementary, secondary and higher education.

Operating transfers are made monthly and are based on estimated income before operating transfers. A portion of the liability to the Lottery Proceeds Fund, equal to the net book value of capital additions after September 1, 1988, is deferred and is not subject to current operating transfers.

2. STATUTORY REQUIREMENTS:

Missouri statutes provide that a minimum of 45% of the money received from the sale of lottery tickets shall be allocated to prizes. The costs of operating the Lottery, including all commissions to retailers, promotional costs, and all other administrative expenditures, are appropriated by the General Assembly of the State of Missouri.

The Lottery receives certain services for no charge from other Missouri state government agencies. Investigative services are provided by the Missouri State Highway Patrol. The Office of Administration provides certain services to process expenditures and payroll for the Lottery.

3. ON-LINE TICKET SALES:

On-line ticket sales consist of the following:

	<u>1997</u>	<u>1996</u>
Powerball	\$ 76,145,527	\$ 89,376,918
PICK 3	48,362,345	46,609,753
LOTTO	31,892,109	32,683,662
Show-Me 5	22,783,598	25,534,373
Daily Millions	9,573,752	-
	<u>\$ 188,757,331</u>	<u>\$ 194,204,706</u>
	=====	=====

4. PROPERTY AND EQUIPMENT:

Property and equipment consists of the following:

	<u>1997</u>	<u>1996</u>
Land	\$ 315,052	\$ 315,052
Building	2,516,871	2,505,721
Computers and related software	4,300,196	3,896,649
Equipment	8,222,345	7,673,242
Autos	1,693,570	1,608,532
Construction in progress	880,768	-
Other	45,000	45,000
	<u>17,973,802</u>	<u>16,044,196</u>
Less- Accumulated depreciation and amortization	<u>10,894,129</u>	<u>8,899,289</u>
	<u>\$ 7,079,673</u>	<u>\$ 7,144,907</u>
	=====	=====

5. PENSION PLAN:

The Lottery participates with other state agencies in the Missouri State Employees' Retirement System (MOSERS) plan. The plan is a multiagency, defined benefit plan that covers substantially all of the Lottery's employees. The Lottery's contributions to the plan are set annually by MOSERS and, in fiscal 1997 and 1996, were approximately \$546,000 and \$509,000, respectively.

6. LEASES:

The Lottery's regional facilities are held under operating lease agreements with renewal options available for one to four additional one-year periods. Annual rent expense for these facilities totaled approximately \$178,000 in fiscal 1997 and 1996.

The Lottery leases ticket vending machines under operating lease agreements with options available for additional one-year periods. Annual lease expense for these machines totaled approximately \$907,000 and \$697,000 in fiscal 1997 and 1996, respectively.

7. CONTRACTUAL ARRANGEMENTS:

The Lottery maintains contractual arrangements with providers of goods and services critical to the Lottery's operations. Significant contracts include an agreement with the provider of the Lottery's on-line game computer systems and agreements with producers of the Lottery's instant and pull-tab games tickets, among others. The contracts generally run for one year, with one-year renewals available at the option of the Lottery. The contracts require the Lottery to compensate vendors for goods and services that meet stated quality standards.

The Lottery is a member of the Multi-State Lottery Association (MUSL) which consists of 21 state and district lotteries (member lotteries) and operates the on-line Powerball and Daily Millions games. MUSL formerly operated the Missouri Megabucks and Lotto*America on-line games. Under separate agreements between MUSL and each lottery, the member lotteries sell tickets for the Powerball and Daily Millions games and remit 50% of sales to prize winners or to MUSL for payment of prizes. Member lotteries also fund MUSL's operating expenses, based on allocations by MUSL.

Grand prize winners of MUSL's Powerball, Missouri Megabucks and Lotto*America games receive prize payments annually over a 20-year period. Investment securities, with maturities that approximate all grand prize winner payments due to winners of MUSL games, are maintained by MUSL. The investments and related prize liabilities for winners of these games from the state of Missouri are excluded from the accompanying grand prize winners trust account statements. Future grand prize winner payments of MUSL games due to winners in Missouri are approximately \$272,166,000 as of June 30, 1997.

The Lottery has contributed to a prize reserve fund and set prize reserve fund, separately maintained by MUSL, to protect MUSL members in case of unforeseen liabilities and to pay certain prizes associated with Powerball, respectively. With certain restrictions, these fund balances are refundable to member lotteries upon termination of the member's agreement with MUSL or upon the disbanding of MUSL. At June 30, 1997, the Lottery's portion of the prize reserve fund and set prize reserve fund was approximately \$3,583,000 and \$2,071,000, respectively.

The Lottery has contributed to an account with MUSL which is used to pay certain operating expenses incurred by member lotteries for the Powerball and Daily Millions games. With certain restrictions, the balances in this account are refundable to the member lotteries upon termination of the member's agreement with MUSL or upon the disbanding of MUSL. At June 30, 1997, the Lottery's portion of the balance in this account was approximately \$456,000.

8. GRAND PRIZE WINNERS TRUST ACCOUNT:

Since March 1990, to fund future payments under grand prize winner prize claims, the Lottery purchases U.S. Treasury zero coupon bonds, with maturities approximating deferred grand prize annuity installment amounts and due dates. The securities purchased are held in the Lottery's name in safekeeping by the Federal Reserve Bank in a separate account for the grand prize winners trust account. The investments in these securities are carried at cost, adjusted for the accretion of discounts based on the purchase yield and the maturity date. Accretion on these investments is not recognized as revenue of the Lottery but is credited to deferred grand prize liability. These securities are not subject to trading and are intended to be held to maturity. The market value of these securities at June 30, 1997 and 1996, was approximately \$102,033,000 and \$91,477,000, respectively. The maturity value of securities held at June 30, 1997 and 1996, was \$161,542,000 and \$147,934,000, respectively.

Scheduled grand prize installment payments to be funded by the maturing U.S. Treasury zero coupon bonds, as of June 30, 1997, are as follows:

<u>Fiscal Year Ending</u>	<u>Amount</u>
June 30, 1998	\$ 10,592,000
June 30, 1999	10,592,000
June 30, 2000	10,592,000
June 30, 2001	10,592,000
June 30, 2002	10,592,000
Thereafter	108,582,000
Total installment payments due	161,542,000
Less- Interest portion	64,597,762
	<u>\$ 96,944,238</u>
	=====

Prior to March 1990, the Lottery purchased annuity contracts from selected insurance companies to fund "LOTTO" grand prize claims. Because it is the intent of the Lottery that the insurance companies make future installment payments directly to each prize winner, neither the value of the annuities nor the value of the related future payments are reflected in the accompanying financial statements. Future installment payments to be made to grand prize winners by these insurance companies totaled approximately \$70,597,000 at June 30, 1997.